OFFICE OF ILLINOIS STATE TREASURER

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Treasurer Frerichs: Without Steps from Governor, Illinois Will Be Issued Junk Bond Status

CHICAGO – As the state's chief investment officer, Illinois State Treasurer Michael Frerichs today laid out the steps Gov. Bruce Rauner must take to prevent Illinois from sinking into junk bond status now that a budget package has been approved.

"The credit-rating agencies have indicated that the new revenue and spending cuts alone are not enough to insulate the state against further credit downgrades, including junk bond status," Frerichs said. "I understand that Gov. Rauner disagrees with the elected members of the House and Senate. However, should he not take these necessary steps, he is inviting the credit-rating agencies to plunge Illinois into junk bond status, the results of which will lead to higher property taxes."

To avoid becoming the first state in history to be assigned junk bond status, the Governor must:

- Travel to New York, speak directly with the three ratings agencies, and convince them that he embraces the decision of the Legislature and will implement the budget package.

- Immediately take visible, responsible steps to implement the $6 billion in bonding authority, which will yield $3 billion in additional federal dollars to pay down the $15 billion bill backlog.

- Make sure that local schools open on-time. K-12 education funding in the budget package is predicated upon a separate agreement that state dollars will be distributed on an evidence-based model. Lawmakers passed legislation that does so. However, the Governor has promised a veto. Vetoing this agreement, or in the alternative, not striking a different deal, will create more instability, which the rating agencies are expecting Illinois to avoid. It also will threaten local schools from Cairo to Chicago and be a complete disaster for parents.

- Clearly and proactively communicate the new tax rates with Illinois employers to eliminate any confusion. Doing so will ensure that revenue estimates and cash-flow expectations are met.

- Eliminate the divisive rhetoric that is impairing our state from moving forward. This divisiveness counters the civility and bi-partisanship the rating agencies wish to see.

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“This mix of revenue and cuts is far from perfect. It is, however, now the law and if implemented it is a critical first step to addressing Illinois’ deep, structural challenges,” Frerichs said. “It is clear that we will not begin to climb out of this debt if the Governor does not take the necessary steps to lead us away from the abyss.”

Earlier this year, Frerichs warned that the inability to reach a budget agreement would invite further credit downgrades that would increase the cost of necessary borrowing. Frerichs also warned of impending junk bond status and, if reached, how that would exasperate the financial markets because some investors are restricted from doing business with entities that have junk bond status. This is true even though entities that purchase Illinois debt have iron-clad constitutional guarantees that they will be paid.

Illinois also uses toxic credit-swap agreements. Junk status invites termination of these agreements. Termination penalties of up to $107 million, in addition to interest rate penalties, could be demanded by the lending agencies.

Illinois has endured eight credit downgrades since Gov. Rauner took office in January 2015. All involved the state’s bill backlog, now estimated to be $15 billion, the budget impasse, and other factors.

The budget package approved by Democrats and Republicans is the first in two years. It was enacted over the Governor’s opposition and plans to spend $36.1 billion in the fiscal year that began July 1, 2017. Currently, the state spends $39 billion annually, so the package represents a $3 billion spending cut. The cuts, combined with new revenue and federal matching dollars, could allow for up to $8 billion of the bill backlog to be addressed.

However, it will take several years, including the likelihood of several more challenging budget packages, for Illinois to eliminate the bill backlog and return to a more acceptable payment cycle of 30-90 days.

About Credit Rating Agencies

There are three primary credit rating agencies: Fitch Ratings Inc., Moody’s Investors Service, and S&P Global Ratings. Each agency assigns government bonds, sometimes called a tax-backed loan, a credit rating. The credit rating, like a credit score, indicates how risky it is to purchase government bonds. The higher the risk, the lower the credit rating; the lower the credit rating, the more expensive it is for Illinois to borrow money. Each agency’s ratings system is similar, although each uses different letter and number combinations to reflect the credit rating. Nevertheless, each rates Illinois’ debt to have speculative elements and a credit risk. Each also has assigned a negative outlook.

Fitch’s Rating is BBB. Moody’s Rating is Baa3. S&P’s rating is BBB-

About the Illinois Treasurer

The Illinois Treasurer is the state’s chief investment officer and Frerichs is a Certified Public Finance Officer. He protects consumers by encouraging savings plans for college or trade school, increasing financial education among all ages, and removing barriers to a secure retirement. As the state’s Chief Investment Officer, he actively manages approximately $25 billion. The portfolio includes $13 billion in state funds, $7 billion in college savings plans and $5 billion on behalf of local and state governments. The investment approach is cautious to ensure the preservation of capital and returns $28 to the state for every $1 spent in operations. The Treasurer’s Office predates Illinois incorporation in 1818. Voters in 1848 chose to make it an elected office.

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